Taxpayer Exposure and the Patient Protection and Affordable Care Act

Testimony prepared for the Republican Health Care Solutions Group Forum:
"The True Cost of the Health Care Law to Families and Employers"

by

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Chairman Blunt and Members of the Health Care Solutions Group thank you for the opportunity to appear before you today. As I am sure you are aware, the United States faces a daunting federal budgetary outlook. As a result, there is a heightened importance attached to the fiscal implications of the Patient Protection and Affordable Care Act (referred to below as the "Bill"). Proponents of the Bill point to the Congressional Budget Office (CBO) analysis that suggests a modest contribution to deficit reduction over the budget window and beyond, or argue that the CBO understates the beneficial reductions in the pace of health care spending.

I have examined these arguments and find that in the end they are unconvincing. Instead, it appears more likely that the Bill will accelerate the coming fiscal crisis.

The Budgetary Context

The federal government's unsustainable long-run fiscal posture has been well understood for quite some time. As depicted in successive versions of the CBO's *Long-Term Budget Outlook*, over the next 30 years, the inexorable dynamics of current law will raise outlays from about 20 percent of Gross Domestic Product (GDP) to between 30 and 40 percent of GDP[1]. As a result, any effort to keep receipts at their post-war norm of 18 percent of GDP will generate an unmanageable federal debt spiral. In contrast, a strategy of ratcheting up taxes to match the federal spending appetite would likely be self-defeating as it would cripple economic growth.

The basic problem is spending that rises above any reasonable metric of taxation for the indefinite future. The diagnosis leads as well to the prescription for action. Over the long-term, the budget problem is primarily a spending problem and correcting it requires reductions in the growth of large mandatory spending programs and the appetite for federal outlays.

[1] See, for example, Congressional Budget Office. The Long-Term Budget Outlook. Washington (DC): Congress of the United States; 2009 Jun.

While this picture of the federal budgetary future has been unchanged for a decade or more, the most recent Administration budget shows that the problem has become dramatically worse and will arrive more quickly. The federal government ran a fiscal 2009 deficit of $1.4 trillion – the highest since World War II – as spending reached nearly 25 percent of GDP and receipts fell below 15 percent of GDP. In each case, the results are unlike those experienced during the last 50 years.

Going forward, there is no relief in sight. Over the next ten years, according to the CBO's analysis of the President's Budgetary Proposals for Fiscal Year 2011, the deficit will never fall below $700 billion dollars[2]. Ten years from now, in 2020, the deficit will be 5.6 percent of GDP, roughly $1.3 trillion, of which over $900 billion will be devoted to servicing debt on previous borrowing.

The budget outlook is not the result of a shortfall of revenues. The CBO projects that over the next decade the economy will fully recover and revenues in 2020 will be 19.6 percent of GDP – over $300 billion more than the historic norm of 18 percent. Instead, the problem is spending. Federal outlays in 2020 are expected to be 25.2 percent of GDP – about $1.2 trillion higher than the 20 percent that has been business as usual in the postwar era.

As a result of the spending binge, in 2020 public debt will have more than doubled from its 2008 level to 90 percent of GDP and will continue its upward trajectory. Traditionally, a debt-to-GDP ratio of 90 percent or more is associated with the risk of a sovereign debt crisis. Indeed, there are warning signs even before the debt rises to those levels. As outlined in its recent report, the credit rating agency Moody's looks at the fraction of federal revenues dedicated to paying interest as a key metric for retaining a triple-A rating[3]. Specifically, the large, creditworthy sovereign borrowers are expected to devote less than 10 percent of their revenues to paying interest. Moody's grants the U.S.

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[2] Congressional Budget Office. An Analysis of the President's Budgetary Proposals for Fiscal Year 2011. Washington (DC): Congress of the United States; 2010 March.

[3] http://www.zerohedge.com/sites/default/files/Moodys%20AAA%20Sovereign%20Monitor.pdf

extra wiggle room based on its judgment that the U.S. has a strong ability to repair its condition after a bad shock. The upshot: no downgrade until interest equals 14 percent of revenues.

This is small comfort as the Obama Administration budget targets 2015 as the year when the federal government crosses the threshold and reaches 14.8 percent. Moreover, the plan is not merely to flirt with a modest deterioration in credit-worthiness. In 2020, ratio reaches 20.1 percent. The U.S. is on track for a junk-bond bonanza.

The Impact of the Patient Protection and Affordable Care Act

In light of the fiscal threat from growing spending, the budgetary impacts of the Bill are central to any discussion of its merits. We begin by reviewing the CBO cost estimate that concludes the Act will serve to lower. In the final score of the Bill th CBO and Joint Committee on Taxation estimated the Act would lead to a net reduction in federal deficits of $143 billion over ten years with $124 billion in net reductions from health care reform and $19 billion derived from education provisions.

Total spending on subsidies in the Bill exceed $1 trillion dollars over ten years and include insurance exchange tax credits for individuals, small employers tax credits, the creation of reinsurance and high risk pools, as well as expansions to Medicaid and the Children's Health Insurance Program. To "pay for" the new entitlement, the Bill purports to impose nearly $500 billion in reductions to annual updates to Medicare fee-for-service payment rates, Medicare Advantage rates, and Medicare and Medicaid disproportionate share hospital (DSH) payments. In addition, the Bill levies more than $700 billion in new taxes from reinsurance and risk adjustment collections, penalty payments by employers and uninsured individuals, an excise tax on high-cost insurance (the "Cadillac" tax), fees on manufacturers and insurers, the so-called Medicare surtax and other revenue provisions.

To gain a rough feel of the longer-run impacts, consider extrapolating the impacts to the years 2020 to 2029 using CBO's estimated compounded annual growth rates. Under

this crude approach, the Bill would be expected to yield an additional $681 billion in deficit reduction.

The prospect of these savings is tantalizing given the daunting fiscal outlook. But they raise an important question: is it really likely that the creation of two new entitlement programs (insurance subsidies and long-term care insurance) will reduce the long-run deficit? The answer, unfortunately, is no.

Realistic Budget Projections

A more realistic assessment likely emerges if one strips out gimmicks and budgetary games and reworks the calculus: the Bill will more likely raise, not lower, federal deficits, by $554 billion in the first ten years and $1.4 trillion over the succeeding ten years.

Why does the outlook change so much? The dubious budgetary provisions fall into four scenarios: unachievable savings, unscored budget effects, uncollectible revenue, and double-counting premiums.

To begin, it is unlikely that the Centers for Medicare and Medicaid Services (CMS) will ultimately be able to implement cost reductions through Medicare market basket updates, the Independent Payment Advisory Board (IPAB) and other projected savings. While the specifics of each differ, these provisions share common features. Most important, the Act does not fundamentally reform Medicare in such a manner that will permit it to operate at lower budgetary cost. Indeed, CMS Actuary Richard Foster analyzed the Bill and concluded that the nation as a whole will spend $310 billion more than it would have without it, large part because of the "negligible financial impact over the next 10 years" for most provisions in the legislation "intended to help control future health care cost growth."
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The increased demand for services will mean that health care shortages and price increases are "plausible and even probable" and that "supply constraints might interfere with providing the services desired by the additional 34 million insured persons." One

would expect in this setting that providers would be expected to negotiate for higher rates, so that health care costs and premiums would increase.

These impacts lead directly to the conclusion that the Bill "jeopardizes access to care" for seniors. As a result of the Bill's payment reductions, "providers for whom Medicare constitutes a substantive portion of their business could find it difficult to remain profitable and, absent legislative intervention, might end their participation in the program (possibly jeopardizing access to care for beneficiaries)." He concludes that about "15 percent of Part A providers would become unprofitable within the 10-year projection period."

It is not hard to imagine what will transpire when the automatic payment reductions are scheduled to occur. CMS will be faced with the possibility of strongly limited benefits, the inability to serve beneficiaries, or both. Congress, recognizing the danger, will be forced to regularly override the scheduled cuts. A similar scenario will apply to proposals from the IPAB. Under the Bill, the IPAB will be obligated to constrain the growth rate of Medicare spending. When faced with the consequences of its proposals, Congress will quickly strip it of its mandate, its independence, or both.

The second misleading aspect of the CBO score is that it ignores acknowledged costs. To operate the new health care programs over the first ten years, future Congresses will need to vote for hundreds of billions in additional spending in the next ten years. The omitted spending begins with the discretionary costs for the Internal Revenue Service (IRS) to enforce and the CMS to administer insurance coverage and explicitly authorized health care grant programs. CBO recently acknowledged that these costs raise the price tag of the Bill[4]. In addition Congress will be forced to revise the sustainable growth rate formula for physician reimbursement in Medicare, which could add in excess of $300 billion to the overall tab. All of these provisions are noted in CBO's report but none of them are factored into the final score of the Bill.

[4] See http://www.cbo.gov/ftpdocs/114xx/doc11493/Additional_Information_PPACA_Discretionary.pdf

In a mirror image to the dubious spending cuts, there are reasons to questions the political will of Congress to collect the excise tax on high-cost or "Cadillac" health insurance. This tax was supposed to start immediately according to the Senate's version of the Bill. After intense lobbying by organized labor, Congress relented and pushed the tax back to 2018. This raises the possibility that it will prove politically infeasible to ever implement the tax leading to a failure to collect the associated tax revenue of $78 billion over the next ten years.

Finally, the Bill double counts premiums for the Class Act and Social Security. In principal, these receipts should be reserved to cover future payments and not be devoted to financing other spending. In the case of the CLASS Act, the Bill raises $70 billion in premiums in the first ten years, while there is a $53 billion anticipated increase in Social Security tax revenue. In both cases, monies that should be dedicated to paying the corresponding long-term care and retirement benefits is being counted on to finance the new entitlement spending for health subsidies.

What is the bottom line? Adding policy realism to the projections produces a radically different bottom line. The Bill would generates additional deficits in excess of $500 billion in the first ten years. And, as the nation would be on the hook for two more entitlement programs rapidly expanding as far as the eye can see, the deficit in the second ten years would approach $1.5 trillion.

Concluding Remarks

The stakes could not be higher as the nation faces a crippling fiscal future. In this environment, the stated impact of the Bill – to reduce deficits by a modest $124 billion over the next ten years – is a mild comfort. Unfortunately, this projection is built on a shaky foundation of omitted costs, premiums shifted from other entitlements, and politically-dubious spending cuts and revenue increases.

Of course, this is not the only source of budgetary uncertainty. Proponents point toward the possibility that the Act will "bend the curve" more than anticipated, thereby reducing health care spending in federal programs and beyond. In this light, it is important to recall that CMS Actuary Richard Foster expects exactly the opposite, suggesting that proponents are rolling the dice at a particularly risky moment in our history.

Moreover, note that if federal subsidies do not grow at all between 2020 and 2029 – a herculean reduction in annual spending growth of 3.4 percentage points – it will reduce outlays by under $500 billion. That is, extraordinary success in bending the cost curve amounts to less than one-third of the downside budgetary risks embedded in the Bill.

I am forced to conclude that the Patient Protection and Affordable Care Act is a horrible policy error at a crucial time. American taxpayers face the threat of much higher demands for their resources, skyrocketing federal borrowing, diminished economic performance, or all of the preceding. It is a cost they cannot afford.